Supreme Court, U. S.
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SEP 2 1977
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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1977

No. 77-346

HARMONT PLAZA, INC.,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR A WRIT OF CERTIORARI

To the United States Court of Appeals
for the Sixth Circuit

RONALD G. GALIP, ESQ.
DONALD DeSALVO, ESQ.
2445 Belmont Avenue
Youngstown, Ohio 44505
Attorneys for Petitioner

St. Louis Law Printing Co., Inc., 812 Olive Street 63101 314-231-4477

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To the United States Court of Appeals for the Sixth Circuit

Harmont Plaza, Inc., an Ohio corporation, petitions for a Writ of Certiorari to review the Judgment of the United States Court of Appeals for the Sixth Circuit entered in this cause on February 8, 1977 (App. A-1).

The Petition for Rehearing in this cause was filed and subsequently denied by the Court of Appeals, and the Order denying said Petition was entered on April 7, 1977 (App. A-2).

OPINIONS BELOW

The Opinion of the Court of Appeals (App., infra, p. A-1) is not officially reported. The Judgment of the United States Tax Court (App., infra, pp. A-3-A-33) is reported at 64 TC 632.

JURISDICTION

The Judgment of the Court of Appeals (App., infra, p. A-1) was entered on February 8, 1977.

The Petition for Rehearing in this cause was filed and subsequently denied by the Court of Appeals, and the Order denying said Petition was entered on April 7, 1977 (App. A-2).

The jurisdiction of this Court is invoked under 28 U.S.C. Section 1254 (1).

QUESTION PRESENTED

Whether an accrual basis taxpayer is required by Section 451 (a) Internal Revenue Code of 1954 and Treasury Regulation Section 1.451-1 (a) to include as income indemnification for a rental loss where the right to receive payment is, by contract, contingent rather than fixed.

STATUTES INVOLVED

Internal Revenue Code of 1954, Section 451 (a) and Treasury Regulation, Section 1.451-1 (a) are set forth at App., infra, p. A-34.

STATEMENT OF THE CASE

In 1968, Petitioner, Harmont Plaza, Inc., was the owner of commercial property located in Youngstown, Ohio. The property in question was, at that time, occupied by Sears, Roebuck under a long term lease. Subsequently, Harmont, (among others) in an effort to develop a new enclosed shopping center to be located in Boardman, Ohio, entered into a series of agreements to accomplish this new development. A new corporation, Southern Park, Inc., was formed for this purpose. In order to develop

the new shopping center, Harmont entered into an agreement whereby Sears, Roebuck was released from its obligation under the Harmont-Sears lease at the Youngstown location and permitted to move to the new center, Southern Park. As an inducement for the Sears move, it was agreed by written contract that Harmont would be indemnified by the new corporation, Southern Park, Inc., for any loss of rental under its Lease with Sears. The right to receive the indemnification payment was (and still is)[1] contingent upon Southern Park, Inc., achieving a positive cash flow to meet this obligation, as well as other obligations having priority status for payment as set forth in the agreements.

On October 13, 1969, Sears vacated the premises in Youngstown, moved to Southern Park, and ceased paying rent to Harmont.

Harmont subsequently leased the premises to another tenant. The amount of rental loss during the interim was $138,729.00 and $354.00 for the fiscal years ending November 30, 1970, and November 30, 1971, respectively.

The Commissioner of Internal Revenue determined that the rental loss should have been accrued and thus included as income by Harmont in the years during which the loss occurred.

The Tax Court affirmed the position taken by the Commissioner.

Petitioner, Harmont Plaza, Inc., subsequent to the decision entered by the United States Tax Court, appealed to the United States Court of Appeals for the Sixth Circuit. The Court of Appeals affirmed the decision of the Tax Court.

Petitioner seeks to have this Court review the Appellate Court's Order affirming the holding of the United States Tax Court in this cause.

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[1] As of this writing, Petitioner, Harmont Plaza, Inc., has yet to receive any payment from Southern Park, Inc., for the rental loss in dispute.

REASONS FOR GRANTING WRIT

The Decisions Below Conflict With the Controlling Decisions of This Court.

The Appellate Court's decision and the decision of the Tax Court are in complete conflict with the holdings of this Court in *Spring City Foundry Co. v. Commissioner*, 292 U.S. 182 (1934); *Commissioner v. Hansen*, 360 U.S. 446 (1959); *Schlude v. Commissioner*, 372 U.S. 128 (1963); and *Lucas v. North Texas Lumber Company*, 281 U.S. 11 (1930).

The Decisions Below Are Contrary to the Holdings of This Court in Spring City Foundry Co. v. Commissioner; Commissioner v. Hansen; and Schlude v. Commissioner.

This Court has long held that a taxpayer must not accrue income until such time as the *right* to receive the income becomes *fixed* and unconditional. (*Spring City Foundry Co. v. Commissioner; Commissioner v. Hansen; Schlude v. Commissioner*) Thus, it is clear that before Harmont can be required to accrue the rental loss under scrutiny herein, it must be shown that the right to receive the rental loss in question has, in fact, become fixed and unconditional. This, of course, presupposes that there exists an unconditional liability on behalf of Southern Park and Sears, Roebuck to pay the amount in question.

The facts in the cause at bar are not disputed. Here, petitioner, Harmont Plaza, Inc. was a successor in interest as landlord to a long term Lease Agreement with Sears, Roebuck as tenant. The Appeals Court and the Tax Court below have agreed that, pursuant to the contracts entered into by and among Harmont, Sears, Southern Park, and others, Harmont waived its right to receive the rent from Sears and substituted in the place of Sears as primary obligor the new corporation, Southern Park, Inc.

(App., pp. A-27-A-28). Pursuant to these contracts, Harmont has no right to receive compensation for the rental loss sustained until the conditions precedent contained in the contracts are satisfied. First and most importantly, the right to receive the compensation for the rental loss is conditioned upon Southern Park, Inc. achieving a net cash flow. Additionally, there is the further condition that, even though a net cash flow is achieved, other accounts are to receive preferential treatment and are, in fact, prior claims.

It was not disputed by the Respondent that Southern Park, Inc. has never yet operated with a net cash flow. Nor was it able to be determined when, if ever, Southern Park would experience a net cash flow. Thus, the contracts executed by and among Petitioner, Southern Park, Sears, and others operate to preclude Petitioner from obtaining a fixed right to receive payment for the rental loss, since neither Southern Park nor Sears has an unconditional liability to pay the amount in question.

The Decisions Below Conflict With This Court's Holding in Lucas v. North Texas Lumber Company.

In 1930 this Court in *Lucas v. North Texas Lumber Company* held that an accrual basis taxpayer could not include as income the purchase price for the sale of property where the purchaser did not have an "unconditional liability" to pay the amount in question. In that case, the taxpayer had included the purchase price in its income statements for the taxable year ending December 31, 1916. The Commissioner of Internal Revenue determined that the gain realized from the sale should not have been included as income in 1916 since the purchase price was not delivered until January 5, 1917. The Board of Tax Appeal sustained the finding of the Commissioner. The Circuit Court of Appeals reversed the Board and, on appeal from the decision of the Circuit Court, this Court held that:

An executory contract of sale was created by the option and notice, December 30, 1916. In the notice the purchaser declared itself ready to close the transaction and pay the purchase price "as soon as the papers were prepared." Respondent did not prepare the papers necessary to effect the transfer or make tender of title or possession or demand the purchase price in 1916. The title and right of possession remained in it until the transaction was closed. *Consequently unconditional liability of vendee for the purchase price was not created in that year. Gober v. Hart,* 36 Texas 139. Cf. *United States v. Anderson,* 269 U.S. 422, 441 [1 USTC Para. 155]. *American National Company v. United States,* 274 U.S. 99 [1 USTC Para. 226]. The entry of the purchase price in respondent's accounts as income in that year was not warranted. Respondent was not entitled to make return or have the tax computed on that basis, as clearly it did not reflect 1916 income. Judgment reversed.

Thus, the only element in *North Texas* remaining to be performed was delivery of documents and payment of the purchase price to the taxpayer, notwithstanding the fact that under basic contract law a binding contract had been reached between the parties at the time the purchaser accepted the offer tendered by the taxpayer. This, of course, occurred in 1916. This Court, however, as we have noted above, held that "unconditional liability" to pay the purchase price was tantamount to the *taxpayer's right to receive* the purchase price. Therefore, the taxpayer could not include the purchase price in its income statement for 1916. (Emphasis Ours.)

In the cause at bar it is undisputed, and the Appeals Court below so found, that Southern Park does not have an unconditional liability to pay the amount of rental loss stipulated by the parties until such time as Southern Park achieves a positive cash flow and pays out of said cash flow the prior claims de-

lineated in the schedule of priorities contained in the contracts entered into between Petitioner and Southern Park. Therefore, Southern Park's "unconditional liability" to pay the rent loss and, conversely, Harmont's right to receive, can only become "fixed" when and if the conditions precedent have been satisfied. In the event these conditions are never satisfied, neither Southern Park, Inc. nor Sears, Roebuck have any obligation to make the payment to Harmont.

The finding of the Tax Court below (and that of the Appeals Court in sustaining said finding) that the conditions contained in the agreements do not rise ". . . to the dignity of what has hitherto been recognized as a contingency sufficient to vitiate the 'fixed' requirement of Section 451(a)" (App., A-29-A-30) is tantamount to reversing this Court's decision in *Lucas v. North Texas Lumber Company.* It is wholly irrelevant that Sears, Roebuck remained secondarily liable under the original Lease Agreement for the years in question, since Sears, Roebuck is not obligated to pay unless Southern Park defaults in payment. What is not irrelevant, however, is the fact that neither Sears nor Southern Park have an "unconditional liability" which would obligate them to pay the rental loss to Petitioner, Harmont Plaza, Inc., until the conditions contained in the agreements are satisfied. The entry of the rental loss in Petitioner's accounts as income for the years in question, therefore, is not warranted, since clearly, such an entry would not accurately reflect income for those years.

CONCLUSION

For the foregoing reasons, a writ of certiorari should issue to review the judgment and opinion of the Sixth Circuit Court of Appeals.

Respectfully submitted,

RONALD G. GALIP

DONALD DeSALVO
2445 Belmont Avenue
Youngstown, Ohio 44505
Attorneys for Petitioner

APPENDIX

APPENDIX A

United States Court of Appeals
For the Sixth Circuit

Harmont Plaza, Incorporated,
Petitioner-Appellant,
v.
Commissioner of Internal Revenue,
Respondent-Appellee.
} No. 75-2455

Order

(Filed February 8, 1977)

Before: PECK, LIVELY and ENGEL, Circuit Judges.

This appeal, perfected from an order entered by the Tax Court affirming certain income tax determinations made by the respondent-appellee, has been submitted on the record on appeal and on the briefs and oral arguments of counsel. Being fully advised in the premises, the Court concludes that the items in dispute were properly assessed against the petitioner-appellant as income returnable by it for the fiscal years ending November 30, 1970, and November 30, 1971, respectively, for the reasons set forth in the opinion filed by Judge William M. Drennen of the Tax Court of the United States, 64 T.C. No. 64, and therefore,

It Is Ordered that the judgment of the Tax Court be and it hereby is affirmed.

Entered by Order of the Court

/s/ JOHN P. HEHMAN
Clerk of Court

United States Cour of Appeals
For the Sixth Circuit

Harmont Plaza, Incorporated,
Petitioner-Appellant,
v.
Commissioner of Internal Revenue,
Respondent-Appellee.
No. 75-2455

Order

(Filed April 7, 1977)

Before: PECK, LIVELY and ENGEL, Circuit Judges.

Upon consideration of the petition for rehearing filed herein by petitioner-appellant, the court concludes that the issues raised therein were fully considered upon the original submission and decision of this case.

It is therefore Ordered that the petition for rehearing be and it hereby is denied.

Entered by Order of the Court

/s/ JOHN P. HEHMAN
Clerk of Court

APPENDIX B

64 T.C. No. 64

United States Tax Court

Harmont Plaza, Inc., Petitioner v. Commissioner of Internal Revenue, Respondent

Docket No. 7767-73. Filed July 24, 1975

Petitioner leased property it owned in Youngstown, Ohio, to Sears, Roebuck & Co. under a long-term lease. In 1968, the Cafaros, who owned 90 percent of petitioner's stock, entered into an agreement with the DeBartolo interests to build an enclosed shopping mall on property owned by the two interests in Boardman, Ohio. A new corporation, Southern Park, Inc., was formed for that purpose. In order to induce Sears to move from the Youngstown location to Southern Park the interested parties entered into various agreements whereunder Southern Park, Inc., indemnified petitioner for any loss of rental under its Sears lease. Payments under the indemnification arrangement were subject to Southern Park, Inc., realizing sufficient cash flow to meet other obligations. Petitioner did not receive any payments for loss of rental under the Sears lease in 1970 and 1971. *Held*, petitioner had a right to receive the rental or indemnification therefor that was fixed in 1970 and 1971 and is required to accrue the agreed amount thereof as income in 1970 and 1971.

Ronald G. Galip and *Donald DeSalvo*, for the petitioner.
Larry L. Nameroff, for the respondent.

DRENNEN, *Judge*: Respondent determined deficiencies in the Federal income tax of Harmont Plaza, Inc., as follows:[1]

FYE Nov. 30	*Deficiency*
1967	$27,081.92
1968	12,208.84
1970	11,067.93
1971	369.58

In the statutory notice which gave rise to this action, the respondent added to petitioner's taxable income for each of the years ended November 30, 1970 and November 30, 1971, an amount with respect to depreciation of $965.92. Petitioner concedes the correctness of this adjustment. The sole issue remaining for decision is whether petitioner is required to accrue under section 451(a), I.R.C. 1954, the amounts of $138,729 and $354 for the fiscal years ending November 30, 1970, and November 30, 1971, respectively as rent due under a lease agreement with Sears, Roebuck and Company. The deficiencies for the fiscal years ending November 30, 1967, and November 30, 1968, result from respondent's disallowance of a net operating loss sustained in the fiscal year ending November 30, 1970, which petitioner carried back to the aforementioned years. Accordingly, the 1967 and 1968 deficiencies depend on our determination with respect to the $138,729 of rental income for the fiscal year ending November 30, 1970.

---

[1] On March 1, 1971, petitioner signed Internal Revenue Service Form 870 with respect to its fiscal years ended November 30, 1966, and November 30, 1967, and additional deficiencies were assessed with respect to those years, in the amounts of $10,440.12 and $12,155.68, respectively. On August 5, 1971, petitioner filed an Application for Tentative Refund From Carryback of Net Operating Loss. These adjustments are reflected in respondent's notice of deficiency.

Finding of Fact

Certain facts have been stipulated and are so found.

Petitioner is an Ohio corporation which had, at all times material to this action, its principal place of business in Youngstown, Ohio. Its United States corporate income tax returns, Forms 1120, for the taxable years ending November 30, 1967, November 30, 1968, November 30, 1970, and November 30, 1971, were filed with the Internal Revenue Service Center at Covington, Ky. Petitioner maintained its books and records and filed its income tax returns on the accrual method of accounting.

On June 1, 1955, the Austin Company, as landlord, entered into a lease agreement (hereinafter Sears lease) with Sears, Roebuck and Co. (hereinafter Sears), as tenant, with respect to two parcels of land located in Youngstown, Ohio. In pertinent part, the Sears lease contained the following provisions:

Lease

1. THIS AGREEMENT is made as of June 1, 1955 between THE AUSTIN COMPANY, an Ohio Corporation, hereinafter called Landlord, and SEARS, ROEBUCK AND CO., a New York Corporation, hereinafter called Tenant. The parties agree as follows:

2. Landlord leases to Tenant and Tenant rents from Landlord the premises (hereinafter sometimes called the leased premises) situated in Youngstown, Mahoning County, Ohio, consisting of two parcels of land, located and described, respectively, as follows:

Parcel A: the premises situated on the easterly side of Market Street between Florida Avenue and Indianola Avenue, shown in red outline on the plot plan attached hereto,

marked Exhibit A, signed by Landlord and Tenant and made a part hereof; said parcel being divided by Hylda Street, a public street.

Parcel B: the premises situated in the city block bounded by Southern Boulevard, Brooklyn Avenue, Cottage Grove and Avondale Avenue, shown in red outline on the plot plan attached hereto, marked Exhibit B, signed by Landlord and Tenant and made a part hereof.

TOGETHER with the retail store buildings and improvements on Parcel A and the warehouse building and other improvements on Parcel B to be erected and made by Landlord, as hereinafter provided.

* * * * * * * *

5. The term of this lease shall be *forty (40)* years, commencing on the date upon which Tenant's store on the leased premises is opened for the conduct of business. Within fifteen (15) days after such store opening, Landlord and Tenant will execute and deliver a supplemental agreement hereto fixing the beginning and ending dates of the term. For convenience, the 40 year term is sometimes called the *basic term* and any period or periods for which this lease may be extended is called the *extended term*.

* * * * * * * *

30. Tenant shall have the right to assign this lease or sublet the leased premises, or any part thereof, for any lawful purpose, or to vacate the leased premises; provided, however, that Tenant shall remain responsible for the payment of rent, as hereinafter provided, and for the performance of Tenant's other obligations hereunder, in no event, however beyond the original term or any extended term to which Tenant has agreed in writing.

31. If Tenant assigns this lease or sublets all or substantially all of the leased premises, or if Tenant vacates said premises, the rent payable under this lease, in lieu of all minimum and additional rent hereinbefore provided, shall be *$14,584 (Fourteen Thousand Five Hundred Eighty-Four Dollars)* per month; provided, however, that if thereafter Tenant re-occupies the leased premises and operates Tenant's business therein, Tenant shall thereupon resume payment of the minimum and additional rent hereinbefore provided; and provided further, that if Tenant so assigns or sublets at a monthly rent in excess of that provided for in this paragraph, Tenant will pay such excess to Landlord.

32. If Tenant vacates the leased premises, Landlord shall make every reasonable effort to re-let the same for the best rent obtainable. If the rent received by Landlord from such re-letting, after deducting the cost of advertising and broker's commission, if any, equals or exceeds the rent payable by Tenant under paragraph 31, Tenant shall not be liable to pay such rent. If the rent received by Landlord from such re-letting, after such deductions, is less than said rent payable by Tenant, Tenant shall be liable only for the deficiency.

* * * * * * * *

47. In each lease year of the basic term Tenant will pay to Landlord as rent for the leased premises an amount equal to 2½% of Tenant's net sales made during such lease year up to $8,500,000, plus 1¼% of the next $2,000,000 of net sales, plus 1% of net sales over $10,500,000. Such rent shall be payable within 20 days after the end of each quarter of such lease year, based on the net sales made during such quarter. (The above figures are,

respectively, two and one-half percent, eight and one-half million, one and one-quarter percent, two million, one percent, ten and one-half million, and twenty.)

* * * * * * * *

On May 2, 1963, the Austin Company transferred its interest in the Sears lease to the trustees of Shopping Centers Investment Trust. Subsequently, on November 29, 1966, the trustees of Shopping Centers Investment Trust assigned its interest in the Sears lease to the petitioner, Harmont Plaza, Inc.

Petitioner is 90-percent owned by William M. Cafaro. It is one of approximaely fifty real estate (primarily shopping centers) enterprises controlled by William M. Cafaro or the Cafaro family interests. The Cafaro interests also owned undeveloped real estate in Boardman, Ohio, part of which was contiguous to property owned by Edward J. DeBartolo (hereinafter DeBartolo). To effectuate the development of the Boardman property as a regional shopping mall and to preclude competition between the Cafaro and DeBartolo interests, a new corporation, Southern Park, Inc., was created. Southern Park, Inc., is an Ohio corporation, beneficially owned 65 percent by Edward J. DeBartolo and 35 percent by the children of William M. Cafaro.

On May 1, 1968, Sears, Roebuck and Co., Southern Park, Inc., and Edward J. DeBartolo entered into the following lease assumption agreement regarding the Sears lease:

Lease Assumption Agreement

THIS AGREEMENT, made this first day of May, 1968, between SEARS, ROEBUCK AND CO., a New York Corporation (hereinafter called "Sears"), SOUTHERN PARK, INC., an Ohio Corporation (hereinafter called "Southern Park"), and EDWARD J. DeBARTOLO, an individual, of Youngstown, Ohio (hereinafter called "DeBartolo"),

WITNESSETH:

WHEREAS, of even date herewith, Southern Park, as Landlord and Sears, as Tenant, are entering into a lease for a retail store, an outdoor sales area, and an automotive service center, in Southern Park's development located at the southeast corner of the intersection of Route U. S. 224 and Route 7, Boardman Township, Ohio, and

WHEREAS, DeBartolo owns controlling interest in Southern Park's parent corporation, and

WHEREAS, on June 1st, 1955, Sears, as tenant, entered into a lease with The Austin Company as landlord, for a retail store building, an auto service center, and a garden shop, which buildings are presently occupied by Sears under the terms of said lease dated June 1st, 1955, said buildings being located in the City of Youngstown, Ohio, which lease was subsequently assigned by The Austin Company to Shopping Centers Investment Trust, and subsequently assigned to Harmont Plaza, Inc., the present landlord of said lease dated June 1st, 1955, and

WHEREAS, Sears, as a condition to entering into said lease of even date herewith, are requiring Southern Park and DeBartolo to assume Sears' liability under the terms of said lease dated June 1st, 1955.

NOW, THEREFORE, in consideration of the execution of said lease of even date herewith, it is agreed as follows:

1. Southern Park and DeBartolo hereby agree to assume Sears' obligation as tenant under said lease dated June 1st, 1955, as assigned, and as may have been amended or supplemented.

2. Said assumption by Southern Park and DeBartolo shall become effective on the date that the term commences under said lease dated May 1st, 1968.

3. Sears agrees to release and discharge DeBartolo from the assumption of said lease dated June 1st, 1955 at such

time as the Cash Flow of Southern Park shall equal or exceed Three Hundred Thousand and 00/100 Dollars ($300,000.00) per year.

4. In the event Southern Park or DeBartolo are able to negotiate with the landlord for the cancellation of said lease dated June 1st, 1955, at no cost to Sears, Sears agrees to consent to said cancellation and execute such documents as are necessary to complete the cancellation.

5. The parties hereto agree to enter into such documents as shall be necessary in order to carry into full force and effect the agreements hereto entered into.

IN WITNESS WHEREOF, the parties have executed this agreement the day and year first above written.
Signed in the presence of:

SEARS, ROEBUCK AND CO.
By /s/ [Illegible]
Assistant to the Vive-President

/s/ Robert W. McConnell, Jr.

SOUTHERN PARK, INC.
By /s/ Edward J. DeBartolo
Edward J. DeBartolo
President

/s/ Edith Arquilla

By /s/ Robert J. Schreiber
Robert J. Schreiber
Secretary

/s/ [Illegible]

Thereafter, on May 9, 1968, a supplemental agreement was entered into between the Edward J. DeBartolo Corp., Edward J. DeBartolo, individually, Anthony M. Cafaro (the son of William M. Cafaro) and William M. Cafaro, with respect to the development, construction and operation of a retail shop-

ping center on the Boardman property to be known as Southern Park. In pertinent part, the provisions of this supplemental agreement are as follows:

Supplemental Agreement

THIS AGREEMENT, made this 9th day of May, 1968, by and between THE EDWARD J. DeBARTOLO CORPORATION, of 7620 Market Street, Youngstown, Ohio (hereinafter referred to as "DeBartolo"), EDWARD J. DeBARTOLO, Individually, and ANTHONY M. CAFARO AND WILLIAM M. CAFARO, of 2445 Belmont Avenue, Youngstown, Ohio (hereinafter sometimes collectively referred to as "Cafaro"),

WITNESSETH:

WHEREAS, The Edward J. DeBartolo Corporation and Anthony M. Cafaro, of even date herewith, are entering into an agreement to form a corporation to engage in the development, construction, and operation of a retail shopping center to be known as "Southern Park" (hereinafter referred to as "Said Agreement"), and the parties hereto desire to set forth herein certain additional understandings and agreements,

NOW, THEREFORE, in consideration of the presents and the mutual covenants of the parties hereinafter set forth, IT IS AGREED as follows:

1. **Land Financing**

The purchase price in the amount of Two Million Two Hundred Eighty-Four Thousand Three Hundred Fifty-Three and 00/100 Dollars ($2,284,353.00) to be paid by the corporation being formed under the terms of Said Agreement (hereinafter referred to as the "Corporation"), to Anthony M. Cafaro as set forth in Paragraph 5 of Said Agreement shall be paid as follows:

(A) Assumption by the Corporation of the mortgages set forth on Exhibit "G" of Said Agreement, all of said mortgages having a remaining principal balance of One Hundred Eighteen Thousand Five Hundred Sixty-Two and 73/100 Dollars ($118,-562.73).

(B) Assumption by the Corporation of a note from The Cleveland Trust Company in the approximate principal amount of Two Million Two Hundred Thousand and 00/100 Dollars ($2,200,000.00) with one half of the principal due February, 1969, and the balance due February, 1970, with interest at the rate of six and one-half percent (6½%) per annum.

(C) The balance, if any, shall be evidenced by an unsecured note of the Corporation with interest at the rate of six and one-half percent (6½%) per annum, payable to Anthony M. Cafaro, which note shall be due and payable five (5) years from the date thereof, however, the Corporation shall pay said note sooner if funds are available from financing or from cash flow, as hereinafter set forth.

In the event the assumptions provided for above exceed the purchase price to Cafaro, such excess amount shall be immediately paid by Cafaro to the Corporation at the time of the payment of said Cleveland Trust note. Cafaro warrants and represents that the terms of the mortgages as set forth on Exhibit "G" attached to Said Agreement are true and correct. It is understood and agreed that the Corporation shall be required to assume said Cleveland Trust note as above set forth, however, the Corporation shall not be required to furnish any security for the payment of said note. It is understood and agreed that neither Anthony M. Cafaro, nor William M. Cafaro shall be required to furnish any money to the Corporation

except for the stock subscription price payable by Anthony M. Cafaro as provided for in Said Agreement.

The purchase price in the amount of Eight Hundred Ninety-Six Thousand Five Hundred and 00/100 Dollars ($896,500.00) to be paid by the Corporation to DeBartolo as set forth in Paragraph 5 of Said Agreement shall be paid as follows:

(A) Assumption of a mortgage to The Mahoning National Bank in the principal amount of Three Hundred Fifty Thousand and 00/100 Dollars ($350,-000.00).

(B) Assumption of the mortgage to The Home Savings and Loan Company on Lot No. 9 in the principal amount of Two Thousand Seven Hundred Forty-Seven and 53/100 Dollars ($2,747.53).

(C) The balance of the purchase price shall be evidenced by a promissory note of the Corporation with interest at the rate of six and one-half percent (6½%) per annum, payable to DeBartolo. The terms of said note shall provide for payment of five (5) years from the date thereof, however, the Corporation shall pay said note sooner if funds are available from financing or from cash flow as hereinafter set forth.

The Corporation shall have the right to borrow land, construction, and permanent financing, including any second mortgages, in such amounts, for such terms, and for such security as the officers of the Corporation determine.

* * * * * * * *

3. **Competition Agreement**

[This paragraph sets forth noncompetition provisions among all four parties.]

4. **Lease Commitments**

Exhibit "A" attached hereto is a list of lease commitments which have been made by Cafaro. DeBartolo agrees to contact all of such tenants set forth on Exhibit "A" and agrees to use his best efforts to consummate leases with said tenants for the proposed mall shopping center. In the event leases are not consummated with any one or more of the tenants listed, the parties hereto agree to cause the Corporation to indemnify Cafaro from any losses incurred by reason of the failure to consummate a lease in accordance with the terms set forth on Exhibit "A" attached hereto. [Not included herein.]

* * * * * * * *

6. **Lease Indemnity**

DeBartolo controls the ownership of buildings known as the Greater Boardman Shopping Center and which includes as tenants J. C. Penney Company, Inc. and The May Department Stores Company. Cafaro controls the ownership of Harmont Plaza Inc., an Ohio Corporation which owns the buildings leased to Sears, Roebuck and Co. in Youngstown, Ohio, known as the Main Sears Store Building, the Sears Auto Service Center, the Sears Garden Shop, and the Sears Warehouse. The parties hereto contemplate that all three of such tenants shall be tenants in the new enclosed mall shopping center and in order to conclude such leases, the parties agree that it will be necessary to cancel all of the existing leases with said tenants. The parties hereto agree that the Corporation shall indemnify DeBartolo for all loss of rental by reason of cancellation of the said lease with J. C. Penney Company, Inc. and The May Department Stores Company, and shall indemnify Cafaro and Harmont Plaza Inc. against all loss of rental by reason of cancellation of said lease with Sears, Roebuck

and Co. The parties hereto agree to use their best efforts to re-let on the best terms available and as quickly as possible the premises being vacated by said tenants, so as to minimize the amount of the net loss of rental. In the event such premises are re-let, the Corporation shall be liable only for the amount of the net loss of rental, if any. The net loss of rental shall equal the amount of rental less the amount the premises can be re-let for after first deducting the cost of re-letting, including any necessary repairs and/or alterations to such premises in order to accomplish such re-letting.

In determining the amount of the loss of rental to DeBartolo pertaining to The May Department Stores Company, the base amount shall be the minimum rental currently payable by The May Department Stores Company in the amount of Seventy-Five Thousand and 00/100 Dollars ($75,000.00) per annum, and pertaining to J. C. Penney Company, Inc., the base amount shall be the average of the annual rental paid by J. C. Penney Company, Inc. for the five full lease years immediately preceding the date of this Agreement. In determining the amount of loss of rental to Cafaro and Harmont Plaza Inc. under the Sears, Roebuck and Co. lease, the base amount shall be the average of the annual rental paid by Sears, Roebuck and Co. for the five full lease years immediately preceding the date of this Agreement. It is understood that Sears, Roebuck and Co. has agreed to enter into a long term lease of at least thirty (30) years of the warehouse at an annual rental of Fifty-Four Thousand Dollars ($54,000.00) with Cafaro or Harmont Plaza, Inc., and that the proceeds of said lease shall be applied to the reduction of the loss of rental of the other Sears facilities.

Cafaro and Harmont Plaza, Inc. agree to use their best efforts to sell the above referred to Sears property so as to

minimize the obligation of the Corporation under the terms to be reasonably approved by all of the parties to this Agreement.

7. **Priority of Cash Flow**

The cash flow of the Corporation shall be paid out in accordance with the following priority:

(A) The management fee

(B) Reasonable reserve to cover possible increase in expenses such as real estate taxes.

(C) For the payment of any unpaid land

(D) For any unpaid fees permitted under the terms of Said Agreement exclusive of the construction profit fee

(E) For the lease indemnity as provided for in paragraph 6 of this Agreement. In the event there is not sufficient cash flow to cover all of the lease indemnities, sixty-five percent (65%) of the amount of cash flow available after payment of (A), (B), (C), and (D) above shall be paid to DeBartolo and the balance of thirty-five percent (35%) of all such cash flow available after payment of (A), (B), (C), and (D) above shall be paid to Cafaro and Harmont Plaza Inc.

(F) The three percent (3%) construction profit fee

(G) Distribution to stockholders in proportion to the amount of stock ownership.

This Agreement shall inure to the benefit of and be binding upon the heirs, successors and assigns of the parties hereto.

IN WITNESS WHEREOF, the parties have executed this instrument the day and year first above written at Youngstown, Ohio.

THE EDWARD J. DeBARTOLO CORPORATION

By /s/ Edward J. DeBartolo
Edward J. DeBartolo
President

By /s/ Robert J. Schreiber
Robert J. Schreiber
Secretary

/s/ Edward J. DeBartolo
Edward J. DeBartolo

/s/ William M. Cafaro
William M. Cafaro

/s/ Anthony M. Cafaro
Anthony M. Cafaro

Southern Park, Inc., proceeded with the development and construction of the Southern Park mall. By the end of 1969 the mall was substantially completed, although not fully leased, and open to the general public. The Cafaro interests did not become involved in the management of Southern Park Inc.; they held only a 35-percent stock interest in the corporation.

Subsequently, on June 30, 1970, the petitioner, Harmont Plaza, Inc., Sears, Roebuck and Co., Southern Park, Inc., the Edward J. DeBartolo Corp., Edward J. DeBartolo, individually, Anthony M. Cafaro, and William M. Cafaro entered into the following agreement regarding the prior agreements, *supra.*:

Agreement

THIS AGREEMENT made this 30th day of June, 1970, by and between HARMONT PLAZA, INC., an Ohio Cor-

poration, hereinatfer referred to as "HARMONT", SEARS, ROEBUCK & CO., a New York Corporation, hereinafter referred to as "SEARS", SOUTHERN PARK, INC., an Ohio Corporation, hereinafter referred to as "SOUTHERN PARK", THE EDWARD J. DeBARTOLO CORPORATION, an Ohio Corporation, hereinafter referred to as "DeBARTOLO CORPORATION", EDWARD J. DeBARTOLO, an Individual, of Youngstown, Ohio, hereinafter referred to as "DeBARTOLO", and ANTHONY M. CAFARO and WILLIAM M. CAFARO, Individuals of Youngstown, Ohio, hereinafter referred to as "CAFARO."

WITNESSETH:

WHEREAS, SEARS did let and lease from the Austin Company by Lease dated June 1, 1955, hereinafter sometimes referred to as "Said Lease", premises situated in the City of Youngstown, Mahoning County, Ohio, consisting of two (2) percels [*sic*] of land located and described respectively as follows:

Parcel A: the premises situated on the easterly side of Market Street, between Florida Avenue and Indianola Avenue, said parcel being divided by Hylda Street, which land is more fully described on Exhibit "A", attached hereto and made a part hereof by reference;

Parcel B: the premises situated in the city block bounded by Southern Boulevard, Brooklyn Avenue, Cottage Grove and Avondale Avenue, which land is more fully described on Exhibit "B", attached hereto and made a part hereof by reference;

together with the retail store buildings and improvements on Parcel A and the warehouse building and other improvements on Parcel B; and

WHEREAS, HARMONT has succeeded to the interest of the Austin Company under said Lease and HARMONT and SEARS have entered into a Memorandum of Lease dated July 22, 1968, recorded in Mahoning County records in Volume 148 at Page 282, and

WHEREAS, DeBARTOLO CORPORATION, CAFARO and DeBARTOLO entered into a Supplemental Agreement, hereinafter referred to as "Supplemental Agreement", dated May 9, 1968, whereby, among other things, it was provided SOUTHERN PARK would indemnify CAFARO and HARMONT against all loss of rental as a result of SEARS relocating from the above referenced Parcel A or Parcel B premises to premises in the Southern Park Mall, Boardman, Ohio; and

WHEREAS, SEARS, SOUTHERN PARK and DeBARTOLO have entered into an agreement dated May 1, 1968, hereinafter referred to as "Lease Assumption Agreement", whereby SOUTHERN PARK and DeBARTOLO have assumed SEARS liability under the terms of Said Lease under terms and conditions as more specifically set forth in said Lease Assumption Agreement; and

WHEREAS, SEARS has vacated the premises referred to as Parcel A above but are still in occupancy of the premises referred to as Parcel B above; and

NOW THEREFORE, in consideration of the mutual covenants herein contained the parties agree as follows:

1. It is agreed by HARMONT, DeBARTOLO, DeBARTOLO CORPORATION, SOUTHERN PARK AND CAFARO that the indemnification for loss in rental from Parcels A and B, as contained in the Supplemental Agreement, is limited to One Hundred Seventy-Nine Thousand Two Hundred Twenty-Nine and 00/100 Dollars ($179,229.00) per year.

2. SEARS, SOUTHERN PARK, CAFARO, DeBARTOLO and DeBARTOLO CORPORATION hereby approve the Leasing by HARMONT to Treasure Island Department Stores of Youngstown, Inc., hereinafter referred to as "Treasure Island", the Parcel A premises and the improvements thereon, without any of said parties being released from any liability under Said Lease or the Lease Assumption Agreement or the Supplemental Agreement. The Lease with said Treasure Island shall be in the form attached hereto as Exhibit C and made a part hereof by reference. The parties specifically acknowledge that Said Lease provides for an annual minimum rent of One Hundred Thirty-Five Thousand and 00/100 Dollars ($135,-000.00) with provision for (2) months free rental (Article 4 of Exhibit C) and a credit against the third month's rental of Six Thousand and 00/100 Dollars ($6,000.00) (Article 33 of Exhibit C) and for a term ending February 28, 1981, as well as two (2) five-year renewal options.

3. DeBARTOLO, CAFARO, DeBARTOLO CORPORATION and SOUTHERN PARK hereby consent and approve the reletting of the Parcel B premises referred to above from HARMONT to SEARS for a term of thirty (30) years commencing October 13, 1969, and ending October 12, 1999, at an annual rental of Forty Thousand Five Hundred and 00/100 Dollars ($40,500.00) without being released from liability under the terms of the Supplemental Agreement.

4. HARMONT represents it has not received any income on the Parcel A premises since October 13, 1969, on which date SEARS vacated said premises. For purposes of accounting and establishing the indemnity obligation of SOUTHERN PARK, said parties agree that an annual period ending each September 30th will be used and that following each September 30 commencing with September 30, 1970, HARMONT shall submit to SOUTHERN

PARK, a statement certifying the amount, if any, by which the rental income received by HARMONT during the prior annual period was less than One Hundred Seventy-Nine Thousand Two Hundred Twenty-Nine and 00/100 Dollars ($179,229.00). If rental income exceeds said figure the certification shall so state. If the rental income received is less than said figure, the difference between the rental income received and One Hundred Seventy-Nine Thousand Two Hundred Twenty-Nine and 00/100 Dollars ($179,-229.00) shall be payable by SOUTHERN PARK to HARMONT within thirty (30) days after date of such certification subject to the priority of cash flow as provided in said Supplemental Agreement.

5. HARMONT agrees that it will not amend or modify the lease with Treasure Island in any manner which would extend the term of Said Lease or reduce the rental income without first obtaining the consent of SEARS, SOUTHERN PARK, DeBARTOLO and DeBARTOLO CORPORATION.

6. Except as herein supplemented or amended, DeBARTOLO, DeBARTOLO CORPORATION, SOUTHERN PARK and CAFARO reaffirm their respective obligations under the Supplemental Agreement of May 9, 1968, and the Lease Assumption Agreement.

This Agreement shall bind and inure to the benefit of the parties hereto, their respective heirs, successors and assigns.

IN WITNESS WHEREOF, The parties hereto have executed this Agreement as of the day and year first above written.

Signed in the Presence of:	HARMONT PLAZA, INC.
/s/ Georgiane Cooper	By /s/ William Cafaro
/s/ Janice Lynn Good	By /s/ [Illegible]

SEARS, ROEBUCK & CO.

s [Illegible]

By /s/ [Illegible]
Assistant to the Vice President

s [Illegible]

/s/ Robert W. McConnell, Jr.
Assistant Counsel

Signed in the Presence of:

SOUTHERN PARK, INC.

/s/ Edith Arquilla

By /s/ Edward J. DeBartolo
Edward J. DeBartolo
President

/s/ Dorothy E. Lewis

By /s/ Arthur D. Wolfcale
Arthur D. Wolfcale
Secretary

THE EDWARD J. DeBARTOLO CORPORATION

/s/ Edith Arquilla

By /s/ Edward J. DeBartolo
Edward J. DeBartolo
President

/s/ Dorothy E. Lewis

By /s/ Arthur D. Wolfcale
Arthur D. Wolfcale
Secretary

/s/ Edith Arquilla

/s/ Edward J. DeBartolo
Edward J. DeBartolo

/s/ Janice Lynn Good

/s/ Anthony M. Cafaro
Anthony M. Cafaro

/s/ Georgiane Cooper

/s/ William M. Cafaro
William M. Cafaro

After October 13, 1969, when Sears vacated parcel A, petitioner received no further rental payments from Sears for parcel A. (Parcel A was subsequently relet to Treasure Island Department Stores of Youngstown, Inc. at an annual minimum rent of $135,000.) Parcel B was relet by petitioner to Sears at a fixed annual rental of $40,500. Under the terms of the June 30, 1970, agreement, *supra*, petitioner's right to indemnification for rental loss was limited to $179,229. The amount of net rental loss actually incurred by petitioner for its taxable years ended November 30, 1970, and November 30, 1971, with respect to the Sears lease was $138,729 and $354, respectively. Petitioner did not report these amounts on its income tax returns for fiscal 1970 or 1971. Neither Sears nor DeBartolo nor Southern Park, Inc. has, to any extent, compensated petitioner for this rental loss. As provided in the supplemental agreement of May 9, 1968, *supra*, the indemnification liability of Southern Park, Inc. was subordinated to certain prior claims on the cash flow of Southern Park, Inc. As of the date of trial, these priorities amounted to approximately $6½ or $7 million dollars. From its inception, Southern Park, Inc. has not generated a positive cash flow.

OPINION

The basic issue remaining for our determination is whether petitioner, Harmont Plaza, Inc., must accrue under section 451(a), I.R.C. 1954,[2] for the fiscal years ended November 30, 1970, and November 30, 1971, the amounts of $138,729 and 354, respectively, which represent the amount of net rental loss incurred by petitioner under its lease with Sears as a result of Sears vacating the leased property to move to Southern Park. As a threshold matter, we must ascertain to whom petitioner must look for payment; that is, whether Sears remained the primary obligor as it was under the original 1955 lease agreement or whether Southern Park, Inc. became primarily liable

[2] All references are to the Internal Revenue Code of 1954, unless otherwise specified.

by virtue of the various agreements executed by Sears, the DeBartolo interests, and the Cafaro interests in 1968 and 1970. Resolution of this question rests on whether William M. Cafaro, an officer, director, and 90-percent shareholder of petitioner, was acting on behalf of petitioner in the Supplemental Agreement of May 9, 1968, and whether petitioner, by joining in the Agreement of June 30, 1970, acknowledged a substitution of obligors, to the extent that petitioner was in fact obliged to look to Southern Park, Inc., for indemnification in the event of rental loss.

Respondent points to the fact that the petitioner, Harmont Plaza, Inc., was not a party to either the Lease Assumption Agreement of May 1, 1968, or the Supplemental Agreement of May 9, 1968, and contends that William M. Cafaro was a party to the latter exclusively in his individual capacity. Accordingly, respondent concludes that petitioner was not bound by these agreements and in no way thereunder released Sears from liability. We do not, however, accord such significance to the fact that petitioner was not formally made a party to either of the May 1968 agreements. Instead, on the basis of the evidence adduced at trial and the provisions of the Supplemental Agreement and the Agreement of June 30, 1970, we conclude that William M. Cafaro was acting on behalf of both petitioner and the Cafaro interests in entering into these agreements. Our conclusion comports with what appears to be both the general practice with respect to the Cafaro interests and the specific intent of the parties to those agreements, as well as some of the provisions of the agreements themselves.

The interests of William M. Cafaro and his family comprised approximately fifty various individual, corporate, and other entities engaged, for the most part, in real estate operations. Petitioner's principal witness, who was an officer and director of petitioner and an officer or director of all the other Cafaro companies, not only testified that William M. Cafaro

often acted on behalf of his corporations but also repeatedly referred to "the Cafaro Companies," "Harmont Plaza, Inc.," "we" and "the Cafaro interests" interchangeably. The following exchange at trial serves to illustrate this functional and economic equivalence:

> Q. Was any agreement reached with respect to the Sears property on Market Street?
>
> A. Yes, it was agreed that the—that Sears would be allowed to vacate but I don't think that Harmont—I don't think that we, Harmont Plaza, Inc. or the Cafaro or Mr. William Cafaro had any way of stopping that from happening and still we thought that, you know, to—it would be to the advantage of Harmont Plaza, Inc. and Cafaro—William Cafaro to allow Sears to vacate because the possibilities then were still very good of improving greatly the financial position of Harmont Plaza, Inc.

At a later point, in clarifying that the Cafaro Company to which he had referred was a recently formed corporation, the witness added, "And when I refer to the Cafaro Company, I am sort of, you know, using this term to include all of the corporations controlled by Mr. William Cafaro and his children in trust, or however it may be."

The documents themselves further evidence the congruity of interest between William M. Cafaro and the petitioner, Harmont Plaza, Inc. We turn, for example, to paragraph 6 of the Supplemental Agreement of May 9, 1968, which contains the lease indemnity provisions. As a prefatory matter, the parties specifically note that "Cafaro controls the ownership of Harmont Plaza, Inc., an Ohio corporation which owns the buildings leased to Sears, Roebuck and Co. in Youngstown, Ohio * * *" thereby establishing the identity of interest between petitioner and Cafaro. This identity is explicitly confirmed by the fact that the key indemnification language provides "The parties

hereto agree that the Corporation [Southern Park, Inc.] shall indemnify * * * *Cafaro and Harmont Plaza, Inc.* [emphasis added] against all loss of rental by reason of cancellation of said lease with Sears, Roebuck and Co." notwithstanding the fact that Cafaro, in an individual capacity, was not party to the Sears lease and could not, therefore, technically suffer any rental loss. Similarly, the parties further provided in paragraph 6:

> In determining the amount of loss of rental to *Cafaro and Harmont Plaza, Inc.* under the Sears, Roebuck and Co. lease, the base amount shall be the average of the annual rental paid by Sears, Roebuck and Co. for the five full lease years immediately preceding the date of this Agreement. * * * [Emphasis added.]

and

> *Cafaro and Harmont Plaza, Inc.* agree to use their best efforts to sell the above referred to Sears property so as to minimize the obligation of the Corporation under the terms to be reasonably approved by all of the parties to this Agreement. [Emphasis added.]

The inclusion of Harmont Plaza, Inc., which was not formally a party to the Supplemental Agreement, in the latter excerpt further evidences Cafaro's intention and capacity to represent petitioner therein. These references to both Cafaro and petitioner admit of no other reasonable interpretation than that advanced by petitioner; that is, William M. Cafaro was acting on behalf of petitioner with the result that petitioner was bound by the Supplemental Agreement to look to Southern Park, Inc., for indemnification in the event of rental loss.

In addition we think it is clear that by joining in the Agreement of June 30, 1970, to which Sears, Harmont, and all others interested were parties, Harmont acknowledged and ratified the substitution of Southern Park, Inc., as the party to whom it

should first look for reimbursement of any rental loss resulting from Sears vacating a part of the Youngstown property. That agreement not only makes reference to all of the prior documents relating to the ownership and leasing of the Youngstown property, but is directed entirely toward "accounting and establishing the indemnity obligation of SOUTHERN PARK" for any loss of rental suffered by Harmont as a result of Sears move from Harmont Plaza to Southern Park. See paragraph 4 of the agreement. That paragraph also provides that annually Harmont shall submit to Southern Park a statement certifying the amount by which the rental actually received during the preceding year was less than the minimum rental under the Sears lease and that amount "shall be payable by SOUTHERN PARK to HARMONT within thirty (30) days after date of such certification subject to the priority of cash flow as provided in said Supplemental Agreement."

Respondent, however, directs us to paragraphs 2 and 5 of the June 30, 1970 agreement in support of his contention that petitioner neither was party to the Supplemental Agreement of May 9, 1968, nor released Sears as primary obligor under the Sears lease. Focusing more closely upon the pertinent language of paragraph 2:

> 2. SEARS, SOUTHERN PARK, CAFARO, DeBARTOLO and DeBARTOLO CORPORATION hereby approve the Leasing by HARMONT to Treasure Island Department Stores of Youngstown, Inc., hereinafter referred to as "Treasure Island", the Parcel A premises and the improvements thereon, without any of said parties being released from any liability under Said Lease or the Lease Assumption Agreement or the Supplemental Agreement. * * *

we conclude instead that this provision, by reference to "Said Lease" (the original Sears lease), the Lease Assumption Agreement and the Supplemental Agreement, recognizes and reaffirms the indemnification liability of Southern Park, Inc. Sears is

mentioned therein because of its underlying liability as lessor in the original lease, and we agree, as does petitioner on brief, that Sears was not released from that liability. However, the emphasis throughout the document points to Southern Park, Inc., as the primary obligor for any loss of rental. If Sears had remained primary obligor, it would clearly have been an interested party with respect to the indemnification limitation in paragraph 1; but Sears was not a party to that agreement. Viewed in this light, the language of paragraph 5:

> 5. HARMONT agrees that it will not amend or modify the lease with Treasure Island in any manner which would extend the term of Said Lease or reduce the rental income without first obtaining the consent of SEARS, SOUTHERN PARK, DeBARTOLO and DeBARTOLO CORPORATION.

serves as an additional acknowledgment by Harmont Plaza, Inc. that it must look first to Southern Park, Inc., and then to Sears only in the event that Southern Park, Inc. fails to satisfy its indemnification liability.

In sum, the Lease Assumption Agreement, the Supplemental Agreement and the Agreement of June 30, 1970, evince an overall plan of the Cafaro and DeBartolo interests to effectuate the development of the Southern Park Mall whereby petitioner, as a condition for Sears' participation in Southern Park, acceded to the substitution of Southern Park, Inc.'s indemnification obligation as the primary source of payment.

Having ascertained that petitioner was required to first look to Southern Park, Inc. for payment of the $138,729 and $354 rental loss for fiscal 1970 and 1971, respectively, we must now examine the effect of this indemnification agreement on petitioner's right to receive rental or indemnification for the loss thereof and to determine whether that right satisfied the requisities for accrual under section 451(a) and the regulations

thereunder.[3] Specifically, the issue is whether petitioner possessed a fixed, rather than contingent, right to receive the above payments and if so, whether there nevertheless existed in either of the respective fiscal years sufficient doubt as to collectibility so as to preclude accrual.

As to the first question, it is well settled that accrual is predicated on the existence of a fixed right to receive income rather than actual receipt. *Spring City Co. v. Commissioner*, 292 U.S. 182 (1934); *Commissioner v. Hansen*, 360 U.S. 446 (1959); *Schlude v. Commissioner*, 372 U.S. 128 (1963). Accordingly, where the right to receive is contingent, accrual is not proper, *Lucas v. North Texas Co.*, 281 U.S. 11 (1930). Petitioner contends that accrual of the indemnification payments is unwarranted because under the Supplemental Agreement its right to receive such payments is conditioned upon: (1) Southern Park, Inc. operating with a net cash flow and (2) the cash flow priority schedule set out in paragraph 7. Given the fact that Southern Park, Inc. has from its inception had a deficit cash flow, petitioner would have us conclude that the first criterion not having been satisfied, its right remains contingent and unaccruable.

We disagree, however, with petitioner's characterization of the net cash flow and priority specifications; neither rises to the dignity of what has hitherto been recognized as a con-

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[3] Section 451(a), I.R.C. 1954:

> The amount of any item of gross income shall be included in the gross income for the taxable year, in which received by the taxpayer, unless, under the method of accounting used in computing taxable income, such amount is to be properly accounted for as of a different period.

Sec. 1.451-1. General rule for taxable year of inclusion.

> (a) *General rule.* * * *
>
> Under an accrual method of accounting, income is includible in gross income when all the events have occurred which fix the right to receive such income and the amount thereof can be determined with reasonable accuracy. * * *

tingency sufficient to vitiate the "fixed" requirement of section 451(a). See *Lucas v. North Texas Company, supra.* Unlike specific conditions precedent of performance under a mortgage service contract as in *Guarantee Title and Trust Co. v. Commissioner*, 313 F. 2d 225 (6th Cir. 1963), reversing a Memorandum Opinion of this Court (T.C. Memo. 1961-122), or the relinquishment of a right to interest until the debtor's repayment of a specified Reconstruction Finance Corporation loan, *Standard Lumber Co.*, 35 T.C. 192 (1960), affd. on another issue, 299 F. 2d 382 (9th Cir. 1962), together they are more realistically the incidents of actual receipt rather than the right itself. Instead, we analogize the cash flow and priority schedule provisions to the general subordination characteristic of the ordinary corporate capital structure which, although an index of the prospects of payment, clearly does not of itself preclude corporate creditors from acquiring a fixed right within the meaning of section 451.

Moreover, examination of the key documents (the Lease Assumption Agreement, the Supplemental Agreement, and the Agreement of June 30, 1970), indicates that petitioner accepted Southern Park, Inc. as the primary but not sole obligor. Not only is there no evidence that Sears was completely released from liability but in its Reply Brief petitioner admits that:

> In fact, Petitioner has taken the position that Sears has not been released from liability but that the liability of Sears has been conditioned and qualified; that Sears is only secondarily liable to Harmont; that Harmont must first look to Southern Park, Inc.; * * *. [Petitioner's Reply Brief, p. 7.]

We agree with this statement of the relations between the parties. In permitting Southern Park, Inc.'s indemnification obligation to supercede the rental liability of Sears, petitioner has certainly affected when it might receive payment to the extent that the

cash flow and priority provisions countenance the possibility of delay in actual receipt but has in no way diminished its underlying right to receive.[4] The law is clear that postponement of payment alone does not defer accrual. *Commissioner v. Hansen, supra; Georgia School-Book Depository, Inc.*, 1 T.C. 463 (1943). At most, all petitioner agreed to was a possible postponement of payment of the rent it already had the fixed right to receive.

Notwithstanding our determination that the indemnification liability of Southern Park, Inc. accorded petitioner the requisite fixed right to receive the amounts in issue, it remains for us to further ascertain whether the cash flow and priority schedule factors rendered payment sufficiently doubtful so as to warrant nonaccrual. Where income is of doubtful collectibility or it is reasonably certain that it will not be collected, a taxpayer is justified in not accruing the item. *Corn Exchange Bank v. United States*, 37 F. 2d 34 (2nd Cir. 1930).

We note, however, that this exception has typically been applied where the debtor is insolvent or in fact bankrupt. In the *Corn Exchange Bank* case, *supra*, for example, the debtor from whom interest was owing was in receivership. The mere financial difficulty of the debtor or the fact that a lapse of time is contemplated before actual satisfaction is possible does not constitute the requisite doubtful collectibility. *Commercial Solvents Corporation*, 42 T.C. 455 (1964); *Automobile Ins. Co. v. Commissioner*, 72 F. 2d 265 (2nd Cir. 1934). Applying these principles to petitioner's case, we find the deficit cash flow of Southern Park, Inc. insufficient to establish the degree of financial instability necessary to invoke the exception to accrual. There is

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[4] Petitioner and Sears apparently entered into a lease dated October 13, 1969, covering Parcel B of Harmont Plaza. We would assume that that document would make some reference to the then relationship of petitioner and Sears under the original lease, but the document was not offered in evidence.

no evidence that in 1970 and 1971 petitioner could not ultimately expect payment. Particularly in the context of leveraged real estate transactions, initial cash flow deficits cannot be considered accurate indices of financial viability. Indeed, it often takes several years before the operation "turns around" and generates a positive cash flow. It should be noted further that cash flow is not a constant but a factor which is subject to variation by Southern Park, Inc., itself and, therefore, not reliable as a true barometer of financial conditions. We take a similar view of the priority schedule and do not regard the buildup of priorities incurred in the development of a large retail shopping center like Southern Park as a basis for establishing financial instability.

In sum, neither the existence of a deficit cash flow nor the priority schedule precludes petitioner's right to indemnification payments. We draw support from our analysis in *Georgia School-Book Depository, Inc., supra,* where, in concluding that the taxpayer could reasonably expect payment from the State even though the income in question was payable only from revenue generated by a recently enacted excise tax on beer, we noted that:

> despite the condition of the treasury of the State of Georgia when the free schoolbook fund was inaugurated and for several years thereafter, there was no reasonable expectation that the sums owed by the state to petitioner's publishers and, consequently, the commissions to petitioner itself, would not ultimately be paid. It would naturally take a few years to establish in full working order a system of such magnitude * * *. [1 T.C. at pp. 470-471.]

We, therefore, do not find it necessary to reach the qeustion of whether to prevent accrual because of doubtful collectibility, there must be actual insolvency of the debtor which renders payment improbable (see *Jones Lumber Co. v. Commissioner,* 404

F. 2d 764 (6th Cir. 1968), affirming a Memorandum Opinion of this Court). On the basis of the record before us, we hold that in 1970 and 1971 petitioner had a fixed right to receive rent or indemnification therefor from Southern Park, Inc., as to which there existed no justifiable doubt of collectibility in 1970 and 1971. Accordingly, petitioner is required to accrue in fiscal 1970 and 1971 the respective amounts of $138,729 and $354.

Decision will be entered for the respondent.

APPENDIX C

Internal Revenue Code of 1954

General Rule for Taxable Year of Inclusion

Code Section 451(a) General Rule—The amount of any item of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under the method of accounting used in computing taxable income, such amount is to be properly accounted for as of a different period.

Regulations Section 1.451-1(a) General Rule—Gains, profits, and income are to be included in gross income for the taxable year in which they are actually or constructively received by the taxpayer unless unincludible for a different year in accordance with the taxpayer's method of accounting. Under an accrual method of accounting, income is includible in gross income when all the events have occurred which fix the right to receive such income and the amount thereof can be determined with reasonable accuracy. Therefore, under such a method of accounting if, in the case of compensation for services, no determination can be made as to the right to such compensation or the amount thereof until the services are completed, the amount of compensation is ordinarily income from the taxable year in which the determination can be made. Under the cash receipts and disbursements method of accounting, such an amount is includible in gross income when actually or constructively received. Where an amount of income is properly accrued on the basis of a reasonable estimate and the exact amount is subsequently determined, the difference, if any, shall be taken into account for the taxable year in which such determination is made. To the extent that income is attributable to the recovery of bad debts

for accounts charged off in prior years, it is includible in the year of recovery in accordance with the taxpayer's method of accounting, regardless of the date when the amounts were charged off. For treatment of bad debts and bad debt recoveries, see sections 166 and 111 and the regulations thereunder. For rules relating to the treatment of amounts received in crop shares, see section 61 and the regulations thereunder. For the year in which a partner must include his distributive share of partnership income, see section 706(a) and paragraph (a) of 1.-706-1. If a taxpayer ascertains that an item should have been included in gross income in a prior taxable year, he should if within the period of limitation, file an amended return and pay any additional tax due. Similarly, if a taxpayer ascertains that an item was improperly included in gross income in a prior taxable year, he should, if within the period of limitation, file claim for credit or refund of any overpayment of tax arising therefrom.